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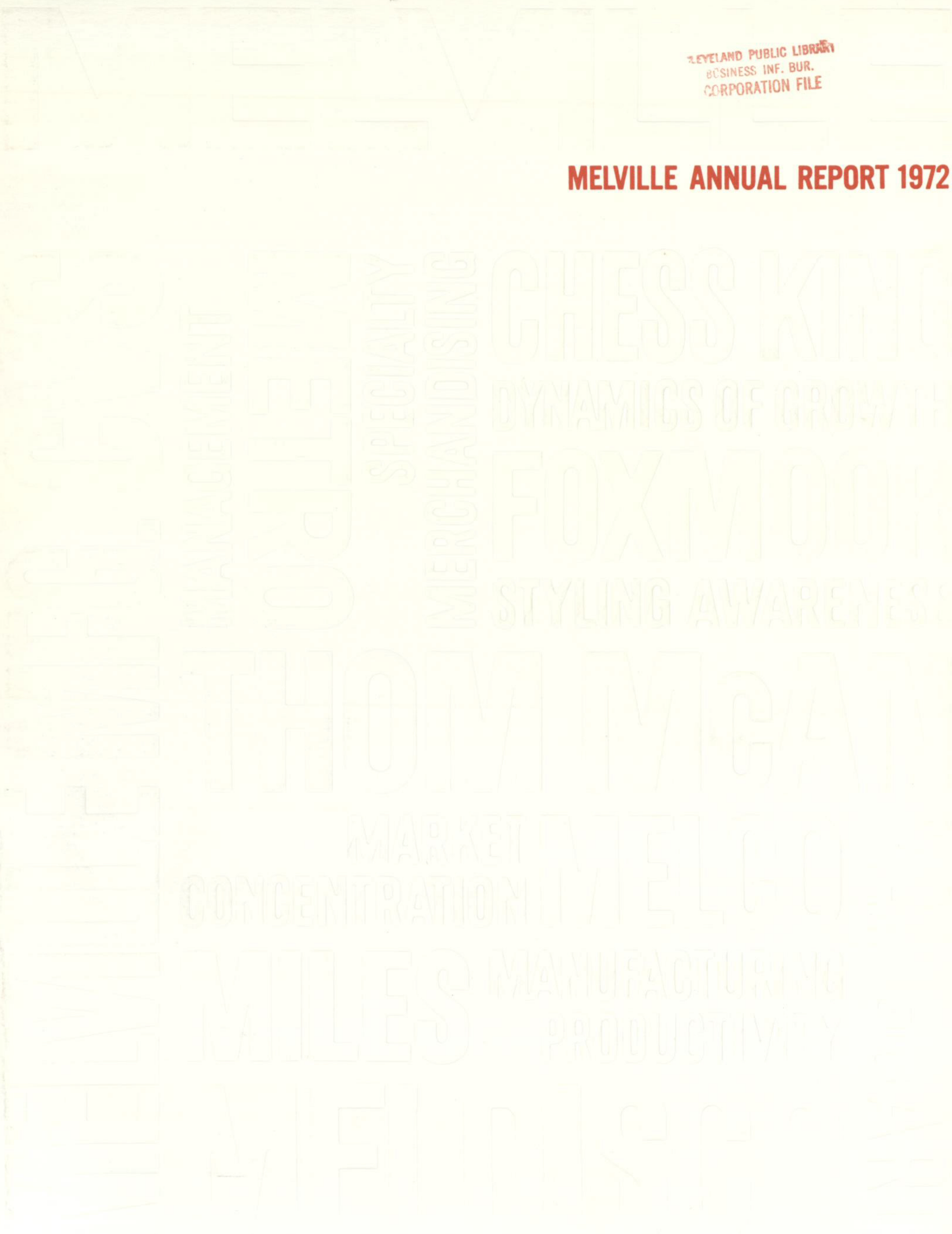
MELVILLE ANNUAL REPORT 1972


MANAGEMENT
SPECIALTY
MERCHANDISING
CHESS KIN
DYNAMICS OF GROWTH
FOXMOO
STYLING AWARENES
THOM MCA
MARKET
CONCENTRATION
MELCO
MILES
MANUFACTURING
PRODUCTIVITY

Melville Shoe Corporation
Annual Report 1972

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Directors and Officers

February 26, 1973

PRESIDENT'S REPORT

Melville Shoe Corporation achieved new highs in sales and earnings in 1972—the company's ninth consecutive year of record results.

Total sales advanced to $631,917,797, a 13.6% increase over last year's record $556,062,224. Earnings climbed to $29,043,722, an 11.9% gain over the 1971 total of $25,959,506. This amounted to net income per share of $1.18 compared with $1.05 in the prior year. The 1971 results have been restated to include the sales and earnings of Clinton Merchandising, Inc. and the Metro Pants/Spotwood Apparel companies acquired in 1972 on a pooling-of-interest basis.

During the year, 292 stores were opened and 115 were closed, increasing the number of units to 2,417 as of December 31, 1972.

Despite the fact that the non-durable portion of the retail sector of the economy was slow in recovering during 1972, Melville had a good year, particularly in the fourth quarter when our earnings increased 20%. Both the shoe and apparel business have been good the past three months.

Thom McAn and Meldisco continued to show gains. Miles, in its effort to reposition itself in the women's specialty shoe business, did not show growth. However, in the past four months the women's business of both Miles and Thom McAn has improved considerably. The non-footwear divisions—CVS, Chess King and Foxmoor—all showed substantial improvement.

The Metro Pants and Clinton acquisitions were completed in December. The Clinton chain, with some 83 health and beauty aid and prescription stores in New York State, Rhode Island, Michigan, Indiana and Pennsylvania, will expand the geographic scope of the CVS division. Metro, a leading manufacturer of men's and boys' pants, will continue to supply Chess King and increase our ability to recognize and respond to consumer preferences in young men's wear.

The Melville manufacturing division's second women's footwear factory, opened in Norway, Maine, in the latter part of the year, will reach full capacity during 1973. Melville has opened four new factories in the past five years, making a total of 18. All factories (other than the new Norway, Maine plant) are running at full capacity and a new plant is under construction in eastern North Carolina at the present time.

In 1973, the company will open approximately 300 stores. All of the divisions of Melville have established their sales and profit goals for the year as well as up-dating their five year plans. With the combination of an improved "soft-goods" economy and the dedication of the entire organization to accomplish their goals, Melville's earnings can be expected to increase for the tenth consecutive year.

Last fall, we moved our corporate headquarters from its long-time location on 43rd Street in New York City to a new, modern two-story building adjacent to the Cross Westchester Expressway at Harrison, New York.

We thank our associates, suppliers, customers and shareholders for their continued confidence in the Melville Shoe Corporation.

Francis C. Rooney Jr.

Francis C. Rooney, Jr.
President and Chief Executive Officer

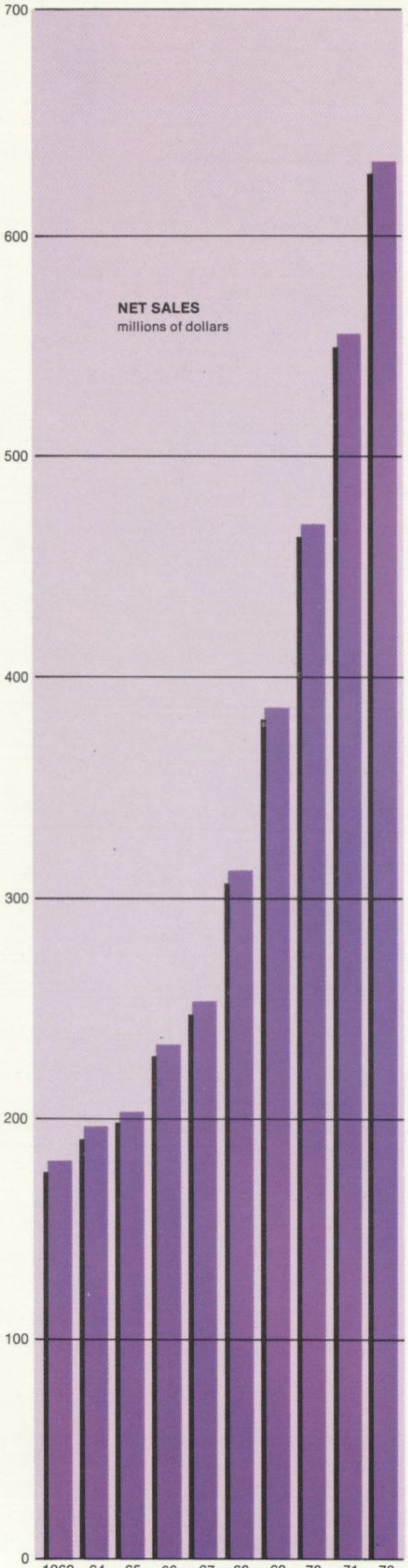
DYNAMICS OF GROWTH

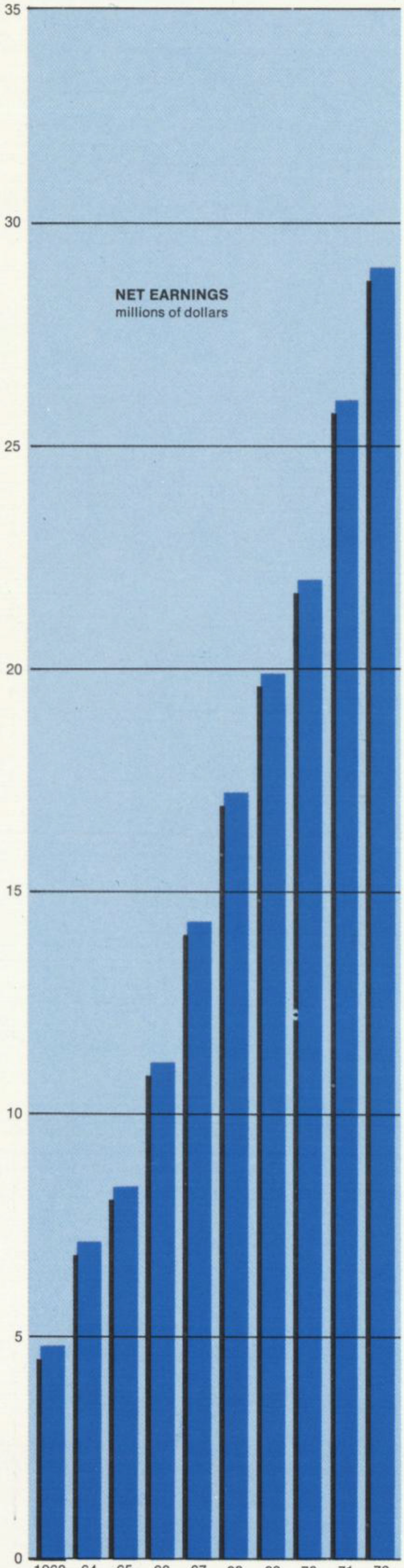
HIGHLIGHTS	**1972**	**1971** (Restated—Note 2)	**Percent Change**
Net Sales	**$631,917,797**	$556,062,224	**+13.6**
Earnings before Federal Income Taxes and Minority Interests	**55,006,236**	47,644,298	**+15.5**
Net Earnings	**29,043,722**	25,959,506	**+11.9**
Dividends on Common Stock	**9,756,756**	9,329,932	**+ 4.6**
Net Earnings Per Share of Common Stock	**1.18**	1.05	**+12.4**
Dividends Per Share of Common Stock	**.416**	.40	**+ 4.0**
Net Earnings as a Percent of Net Sales	**4.60%**	4.67%	
Cash	**31,141,250**	34,085,005	**— 8.6**
Inventories	**130,748,421**	115,407,120	**+13.3**
Net Working Capital	**123,807,122**	105,342,053	**+17.5**
Shareholders' Equity	**140,488,156**	119,824,279	**+17.2**
Average Common Shares, Outstanding	**24,405,215**	24,274,619	**+ 0.5**
Number of Stores	**2,417**	2,240	**+ 7.9**
Number of Employees	**24,386**	21,479	
Number of Shareholders: approximately 17,500			

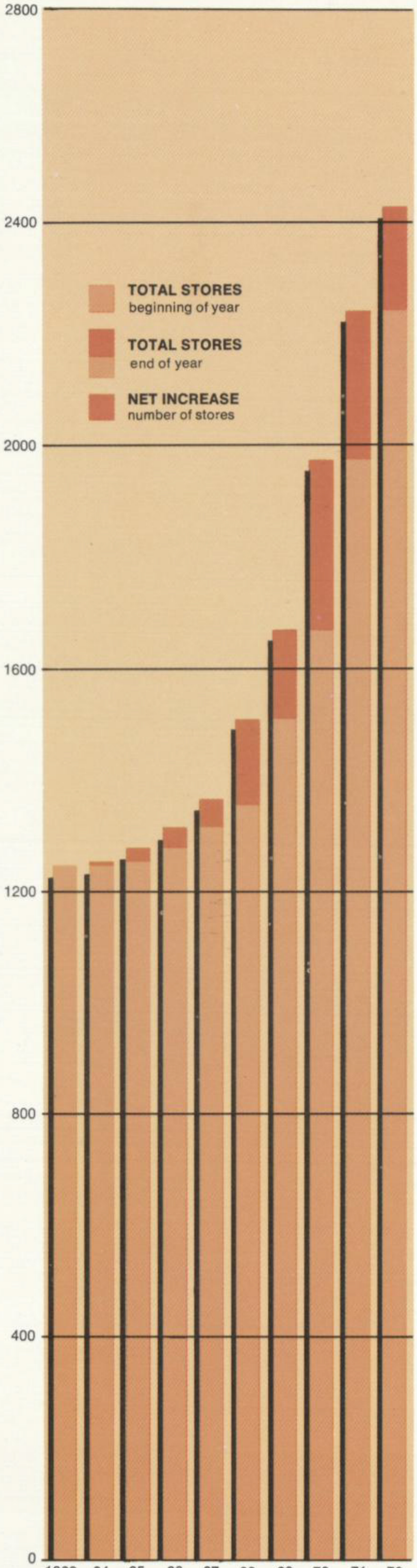
Melville Store Expansion		**1972**			**1973 Est.**		
		OPEN	**CLOSE**	**END**	**OPEN**	**CLOSE**	**END**
Thom McAn	U.S.	54	34	**979**	60	23	**1,016**
	Canada	1	0	**17**	3	0	**20**
Miles		10	34	**236**	10	25	**221**
Vanguard		5	1	**13**	20	0	**33**
Melco		8	0	**19**	12	0	**31**
Foxmoor		44	2	**176**	50	3	**223**
Chess King		32	1	**172**	40	3	**209**
*CVS		30	8	**203**	34	2	**235**
Meldisco		108	35	**602**	90	41	**651**
TOTAL		292	115	**2,417**	319	97	**2,639**

*Includes 83 Clinton Stores

In a decade of sustained growth since 1963, Melville has increased its sales 246%, net earnings 503%, and number of outlets 94%. The company's return on equity, an indicator of management efficiency, was 24.24% in 1972, compared with 12.64% in 1963.







MANAGEMENT

Planned diversification, maximum autonomy, firm financial controls, and management-in-depth have brought a decade of vigorous growth.

Melville's Operating Committee stands in front of the company's new headquarters in Harrison, N.Y. Left to right: Richard E. West, President, J. F. McElwain Co.; Lawrence E. McGourty, President, Thom McAn; Kenneth K. Berland, corporate Financial Vice President; Robert C. Kuhn, President, Meldisco; Francis C. Rooney, Jr., President and Chief Executive Officer of the corporation; John P. Gillig, President, Chess King; Stanley P. Goldstein, President, CVS; Harry Greenberg, President, Foxmoor; William E. Sperry, Vice President-International; J. Richard Nedder, President, Miles Shoes. Absent: Francis H. Gleason, corporate Senior Vice President and Chairman, J. F. McElwain Co.; Arthur B. Gold, President, Melco Shoes.

Melville is organized and managed as a multi-unit corporation made up of mutually related companies operating in the footwear, apparel, and health-and-beauty-aid fields. Through its multi-unit approach, Melville can reach and serve the consumer

in a variety of markets, price-ranges, and types of outlets.

Because Melville's divisions are separate profit-centers, with individual accountability and identity, they have greater opportunity to grow on their own, thus making a maximum contribution to the overall synergistic growth of the corporation.

Melville's continued expansion in footwear has established the company in the various categories of merchandising systems, including straight retail, discount, self-service, and more recently—through a rapidly growing new enterprise—direct mail. Started in 1971, the direct mail department has been selling Thom McAn and special brand Melcort shoes in increasing quantities. It is also offering selections of pants manufactured by one of Melville's newest acquisitions—Metro Pants.

MANAGEMENT *(continued)*

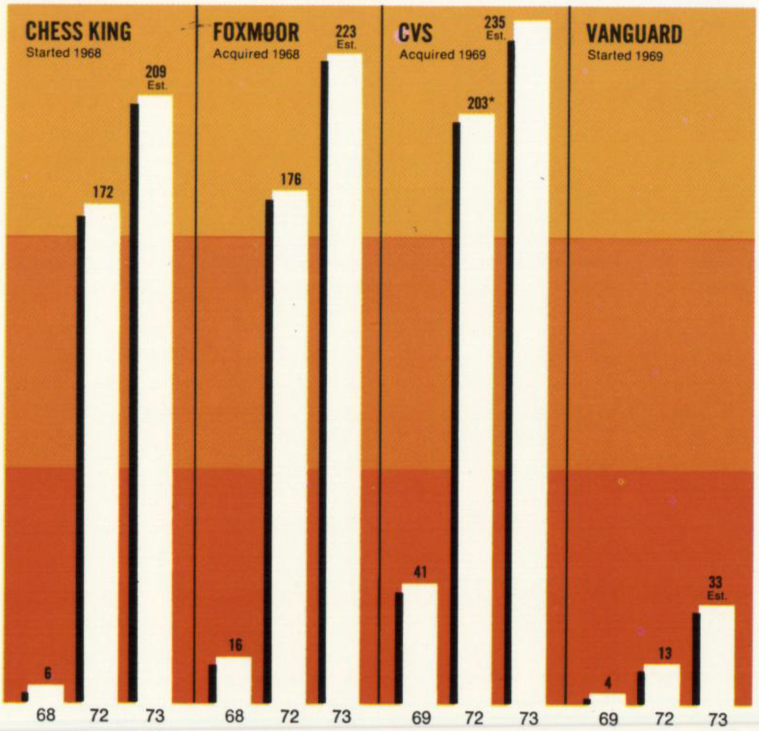
As in footwear, Melville's expansion in apparel has come from the generation of internal growth. Under the Melville aegis, both the company-originated and the acquired chains have grown rapidly and given Melville strong representation in their specialties.

Melville's move into apparel has also created further opportunities for increased volume through "cross-merchandising" between the footwear and apparel operations. At the same time, through CVS, its family discount chain, acquired in 1969, Melville has been steadily expanding in the fast-growing health-and-beauty-aids field. While CVS is the only Melville operation outside of footwear and apparel, it ties in closely with Melville's overall plan of growth through specialty merchandising appealing primarily to young families in suburban areas.

The activities of Melville divisions are coordinated through the Corporate Operating Committee, the main management group which includes corporate officers and the presidents of the divisions.

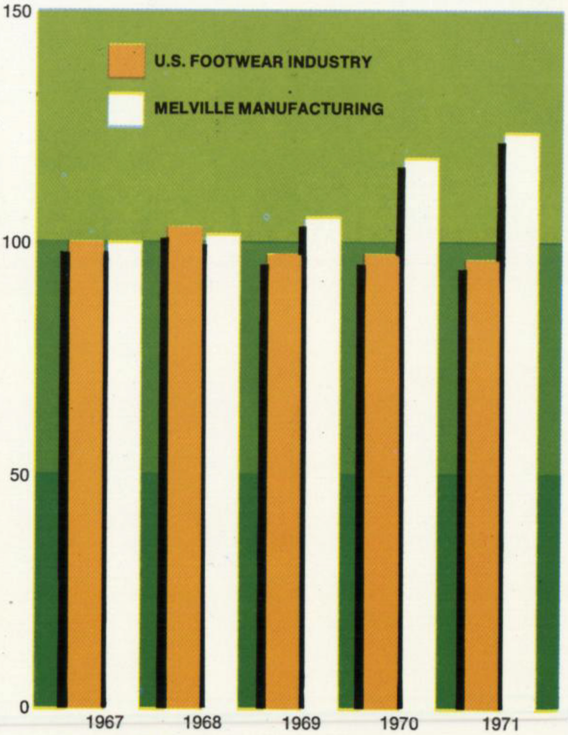
Coordination is achieved through regular meetings of the Operating Committee, periodic reviews of progress toward divisional goals, the maintenance of strong corporate financial controls, and a continuing two-way communication flow from store level to Corporate Headquarters.

"Cross-pollination" of ideas and the



(*Includes 83 Clinton Stores)

NEW CHAIN GROWTH (Number of Stores)



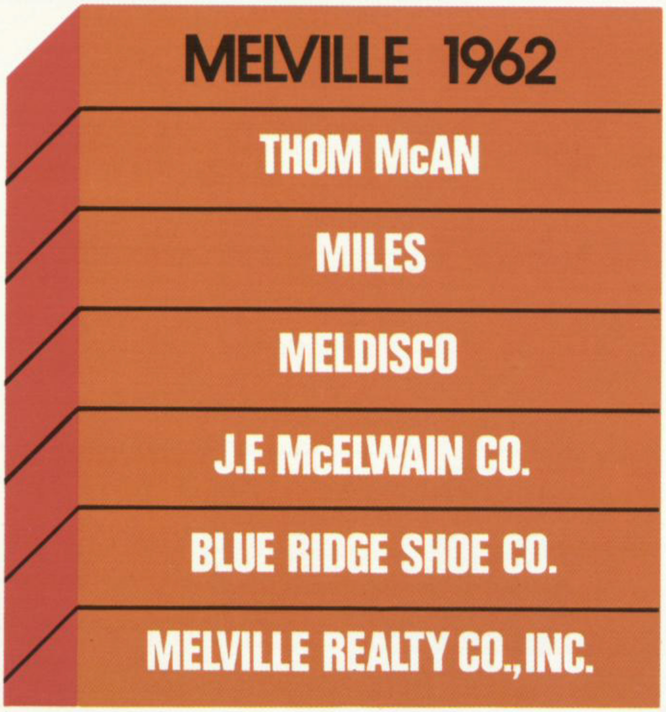
(Base Year 1967)

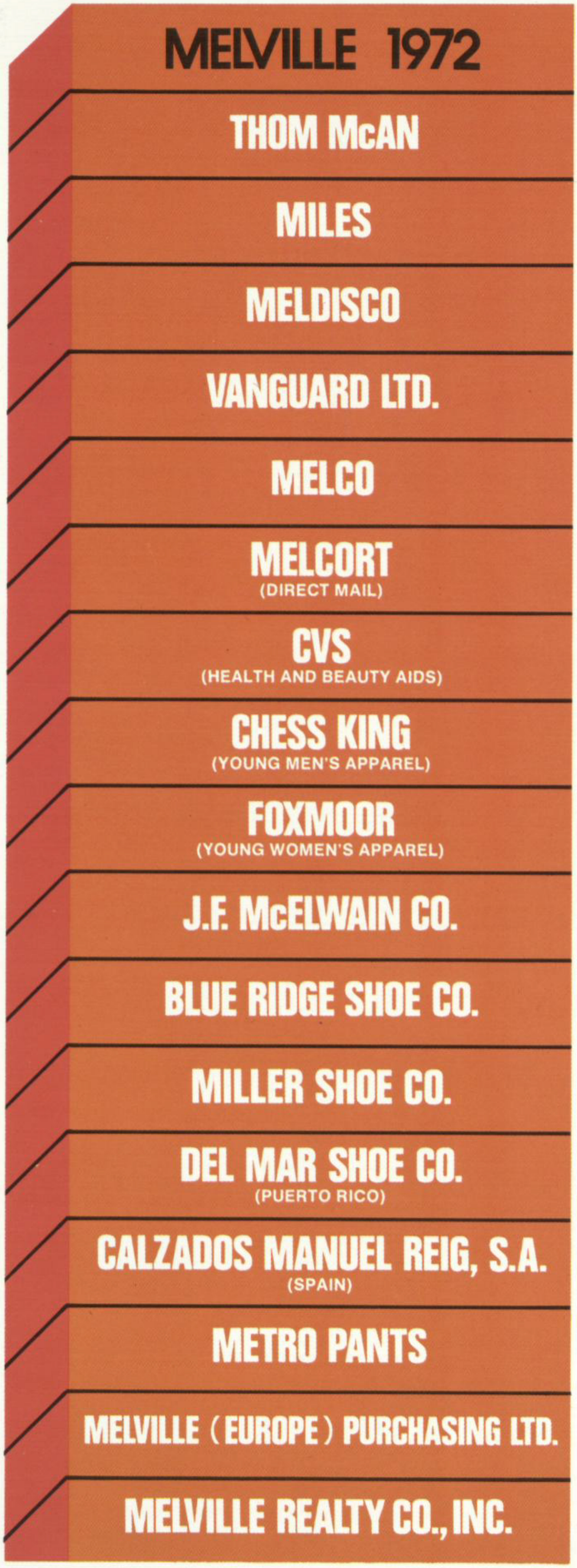
MANUFACTURING PRODUCTIVITY

mutual exchange of services are other advantages of the Melville organizational system. The divisions also have the benefit of the services of the corporate Financial and Real Estate and Construction staffs at a level of capability they could not afford to maintain on their own.

Another major advantage of Melville's system of closely related multi-units operating with maximum autonomy is that each unit produces management talent that is transferable to other units. A continuing flow of managerial talent is further assured through the intensive management recruiting and training programs conducted by the individual operations.

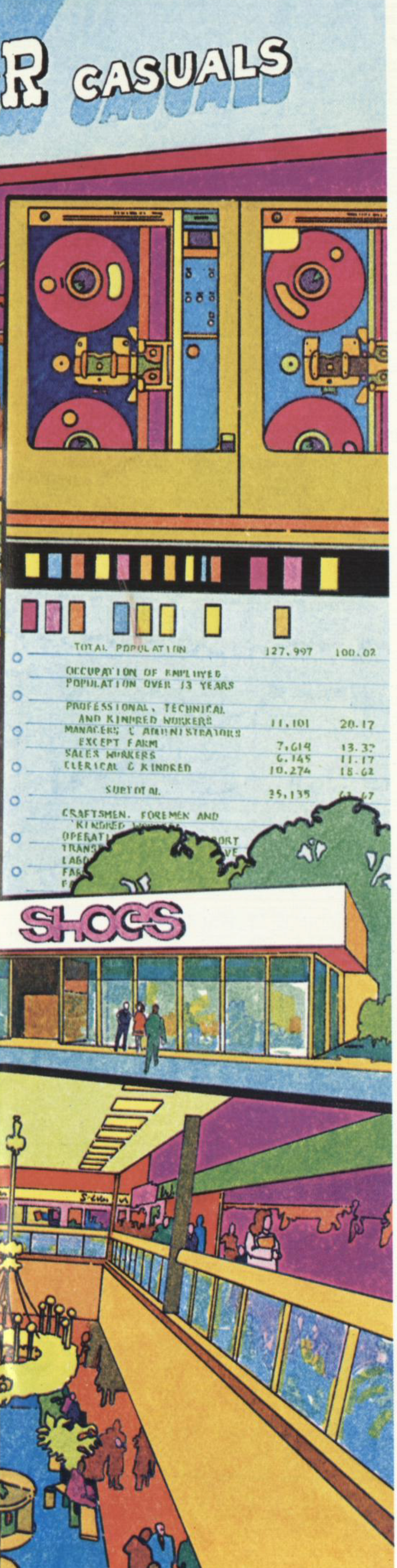
Still another important factor in the development of Melville's management effectiveness has been the company's progressive Incentive Award Program. It allows the individual to establish his own goals within the overall context of the progress of his unit and the corporation itself.


MELVILLE 1962
THOM McAN
MILES
MELDISCO
J.F. McELWAIN CO.
BLUE RIDGE SHOE CO.
MELVILLE REALTY CO., INC.


MELVILLE 1972
THOM McAN
MILES
MELDISCO
VANGUARD LTD.
MELCO
MELCORT
(DIRECT MAIL)
CVS
(HEALTH AND BEAUTY AIDS)
CHESS KING
(YOUNG MEN'S APPAREL)
FOXMOOR
(YOUNG WOMEN'S APPAREL)
J.F. McELWAIN CO.
BLUE RIDGE SHOE CO.
MILLER SHOE CO.
DEL MAR SHOE CO.
(PUERTO RICO)
CALZADOS MANUEL REIG, S.A.
(SPAIN)
METRO PANTS
MELVILLE (EUROPE) PURCHASING LTD.
MELVILLE REALTY CO., INC.

Internal growth of new companies (see chart) has been a major element in Melville progress.

FOXMOO
Thom McAn
chess king
MILES
MELCO
Vanguard
(3) DR. RMS EQUALLY SPACED W/DOORS
WRAP COUNTER TYPE
T BAR INSTALLED FACING WRAP COUNTER (TYPICAL)


R CASUALS
TOTAL POPULATION 127,997 100.02
OCCUPATION OF EMPLOYED POPULATION OVER 13 YEARS
PROFESSIONAL, TECHNICAL AND KINDRED WORKERS 11,101 20.17
MANAGERS & ADMINISTRATORS EXCEPT FARM 7,614 13.37
SALES WORKERS 6,145 11.17
CLERICAL & KINDRED 10,274 18.62
SUBTOTAL 35,135
CRAFTSMEN, FOREMEN AND KINDRED
SHOES

MARKET CONCENTRATION

Rapid store expansion has solidly positioned Melville in the nation's giant new centers.

Melville's high rate of store-openings over the past five years has firmly established the company in the new marketplace of America—the burgeoning suburban and regional shopping centers.

Through the operations of its Real Estate and Construction Departments, which seek out sites and get the stores built once the leases are signed, Melville has opened more than half of its existing stores in the past five years. Melville stores are located in most major shopping centers from coast to coast as well as in Puerto Rico, Hawaii and Canada.

Much of the growth of Melville's specialty chains has depended on the company's ability to open stores rapidly. Chess King had 172 stores at the end of 1972 as compared with 6 at the end of its first year, 1968. Foxmoor, acquired in 1968 with 16 stores—with 11 added as the result of the acquisition of Country Casuals in 1970—now has 176. CVS, acquired in 1969 with 41 stores—and adding the 83-store Clinton chain acquired in 1972—had 203 stores at the end of 1972. Vanguard, started by Melville in 1969, plans to have 33 stores by the end of 1973.

Melville's older chains, with the exception of Miles, have also been growing steadily. Thom McAn had 996 stores at the end of 1972. Meldisco, which operated 272 leased departments in 1968, increased to 602 in 1972.

With more than one store in some 100 centers across the country, Melville has been able to gain favorable locations through leasing greater space, while multiplying its opportunities for expansion.

In its expansion into shopping centers, Melville has also pioneered in the development of store formats that deliver maximum sales per-square-foot, as well as providing effective display of merchandise and the greatest customer convenience.

SPECIALTY MERCHANDISING

In concept, format and merchandise lines, each Melville chain meets special consumer needs.

Today's consumers are individuals who don't fit into convenient demographic slots the way consumers once did. Thus specialty merchandising, appealing as it does to individualized wants, needs, and tastes, has superseded general merchandising as the most effective way of selling in the non-discount field.

Anticipating this trend some five years ago, Melville began building a specialty merchandising organization. Internally and through acquisition, it segmented its operations to conform more closely to the increasingly segmented marketplace.

Melville's specialty stores are mostly small and intimate and have readily identifiable concepts and store formats designed to appeal to specific groups of customers. They carry specialized, in-depth lines of merchandise and the sales personnel have considerable expertise in their given areas. Every effort is directed toward making the customer feel that the store is his own special shopping preserve.

With the consumer's growing tendency to choose a life-style, either consciously or unconsciously, and to buy in a corresponding pattern, the future is even brighter for the specialty merchandising approach. For products will now be "mood related" to an increasing extent. Consumers will be looking for *the* product rather than *any* product in a given category, with each purchase setting off a chain of related purchases.

Given these trends, Melville's new chains—Chess King, Foxmoor, CVS, and Vanguard—are growing rapidly and gaining their fair share of their particular market segments. They are doing business Melville undoubtedly would not have done without them. Their revenues represent a substantial addition to the increasing returns from Melville's Thom McAn, Meldisco and other divisions.

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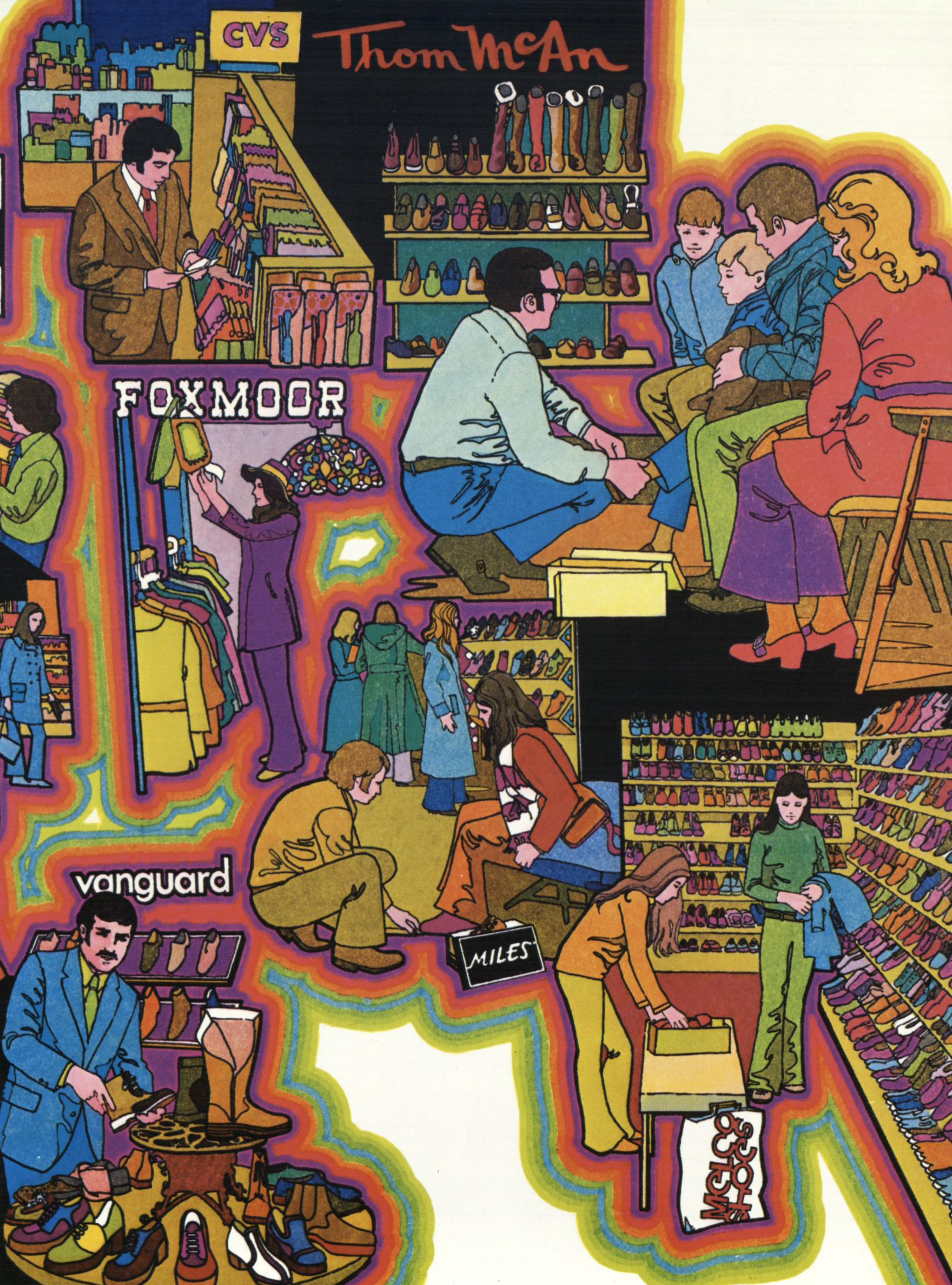

CVS
Thom McAn
FOXMOOR
vanguard
MILES
Shoes

STYLING AWARENESS

With Melville's fashion-oriented footwear and apparel divisions, styling is a prime product.

Three or four times a year, some 20 or 30 buyers, stylists and merchandisers from Melville's footwear and apparel divisions and representatives of Melville Manufacturing meet to sift fashion intelligence, exchange ideas, and make future styling plans.

This is the Melville Fashion Committee. Its existence emphasizes the fact that styling is one of Melville's most important products. While quality and value are of prime consideration, it is a major Melville operating premise that styling moves footwear and apparel.

The achievement of even better styling was one of the reasons Melville, during the past year, set up Melville (Europe) Purchasing Ltd. With buying offices in Italy and Spain and operating throughout Europe, Melville/Europe facilitates the more than $20 million annual purchases by Melville footwear and apparel divisions in Europe. It also keeps Melville's U.S. offices apprised of the latest European styling developments; and works with European designers and manufacturers to develop new styles for Melville's retail divisions.

Also, as an integrated operation, with the close relationship between its retailing and manufacturing operations, Melville enjoys an important competitive advantage in its ability to develop new styles and to move them rapidly into production.

The acquisition in 1970, of the Miller Shoe manufacturing facilities contributed substantially to the improvement of Melville's women's shoe styles.

As important as it is to Thom McAn, Miles and Vanguard in footwear and Chess King and Foxmoor in apparel, styling is also becoming a key concern in the lower priced "budget" lines of Meldisco, Melville's highly successful leased-department operation and Melco, the new family self-service chain operating in free-standing units.

MANUFACTURING PRODUCTIVITY

Its efficient, innovative manufacturing system gives Melville an important marketing edge.

One of the most efficient operations in the footwear industry, Melville Manufacturing, during the period 1967-71, showed a productivity gain of 24% as compared with an industry decline of 4%.

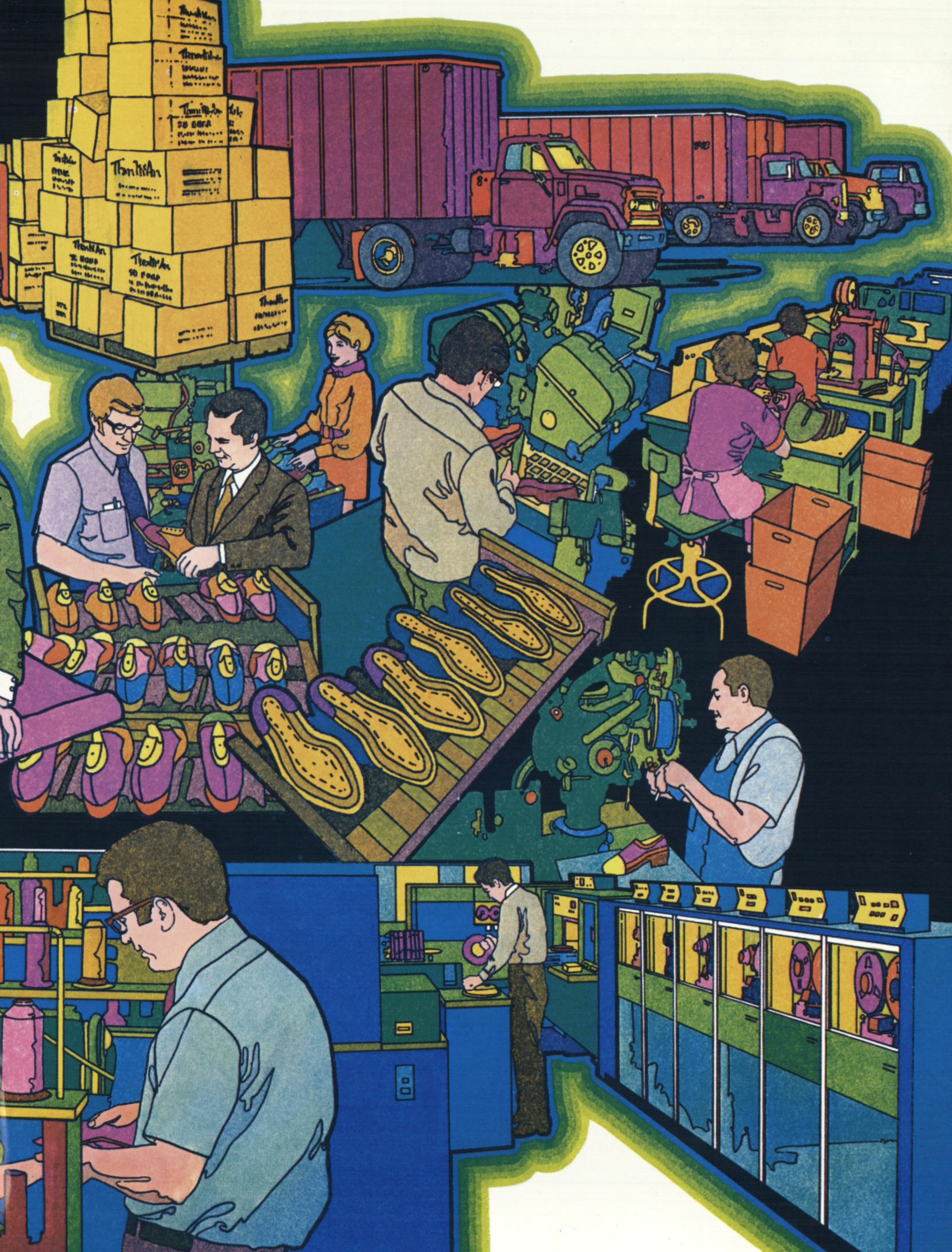
A modern plant system has contributed substantially to Melville Manufacturing's high productivity. Where, ten years ago, Melville had eight plants, all located in New Hampshire and Massachusetts, it now has 18, with four new plants in North Carolina, and one each in Tennessee, Georgia, Maine, New Hampshire, Puerto Rico, and Spain.

The recently completed women's dress and casual shoe plant in Norway, Maine, will double the production capacity of Miller shoes and speed the growth of Melville in the women's shoe field. Also, a new Blue Ridge shoe plant is scheduled for completion in May, 1973 in Aulander, North Carolina. This new plant will produce juvenile footwear and men's and boys' shoes.

The wider use of computers has further improved Melville Manufacturing's productivity. Computer functions have been expanded from the determination of materials needs and factory production-scheduling to product-costing and the maintenance of materials inventories.

Continuing to strengthen its style turn-around capabilities, Melville Manufacturing has initiated a "Hot-line" program to speed the development of new styles for test-marketing and to move them even more rapidly into production.

The division has also established a Research and Development Division as part of its increased emphasis on product and materials testing in response to the needs created by new and different designs, the rising cost of footwear materials, and the constantly changing wants and needs of the modern consumer.


Thom McAn

Ten Year Financial Summary

Melville Shoe Corporation
and subsidiary companies

	1972	1971	1970	1969	1968	1967	1966	1965	1964	1963
Results for the Year (000's omitted)										
Net Sales	**$631,918**	$556,062	$468,236	$386,030	$313,456	$258,752	$234,313	$203,545	$195,171	$182,403
Wages and Compensation	**116,509**	102,859	91,617	78,457	69,111	57,279	51,827	46,122	44,305	41,768
Taxes—All	**39,678**	32,638	26,090	22,165	18,920	15,320	11,797	9,866	10,062	8,192
Earnings Before Federal Income Taxes and Minority Interests	**55,006**	47,644	38,950	34,601	29,453	23,408	17,633	13,668	12,337	8,462
Net Earnings	**29,044**	25,959	22,084	19,939	17,247	14,370	11,192	8,418	7,111	4,814
Dividends Paid	**10,105**	9,690	9,035	7,657	6,416	4,833	3,922	3,281	2,779	4,196
Per Share Results of Common Stock*										
Net Earnings	**$1.18**	$1.05	$ .90	$ .82	$ .74	$ .64	$ .49	$ .36	$ .29	$ .19
Dividends	**.41⅗**	.40	.37½	.32½	.27½	.20	.15⅝	.12½	.10	.16¼
Taxes—All	**1.62**	1.34	1.08	.93	.83	.70	.53	.44	.45	.37
Book Value	**5.40**	4.55	3.84	3.26	2.62	2.17	1.81	1.53	1.29	1.10
End of Year Position (000's omitted)										
Current Assets	**$185,008**	$165,173	$127,674	$111,913	$ 91,482	$ 77,352	$ 67,275	$ 61,596	$ 58,702	$ 49,782
Current Liabilities	**61,201**	59,831	54,647	42,087	32,253	26,119	20,279	18,745	17,273	13,694
Current Ratio	**3.02**	2.76	2.32	2.66	2.84	2.96	3.32	3.30	3.40	3.64
Property, Plant and Equipment (000's omitted)										
At Cost	**$117,895**	$105,816	$ 88,711	$ 73,128	$ 65,128	$ 57,451	$ 53,316	$ 50,361	$ 47,167	$ 47,317
Net After Accumulated Depreciation	**64,821**	58,344	46,006	33,820	26,617	20,893	18,377	17,350	16,030	17,927
Capital Additions	**17,785**	22,383	20,073	14,736	9,059	6,409	4,945	4,971	2,046	2,356
Depreciation	**9,309**	7,769	5,726	4,575	3,950	3,455	3,292	3,148	3,272	3,308
Percent to Net Sales										
Earnings Before Federal Income Taxes and Minority Interests	**8.70%**	8.57%	8.32%	8.96%	9.40%	9.05%	7.53%	6.72%	6.32%	4.64%
Net Earnings	**4.60%**	4.67%	4.72%	5.17%	5.50%	5.55%	4.78%	4.14%	3.64%	2.64%
Percent Net Earnings to Shareholders' Equity	**24.24%**	25.38%	25.13%	27.98%	29.58%	28.16%	24.41%	19.87%	18.52%	12.64%
Number of Stores	**2,417**	2,240	1,973	1,666	1,510	1,366	1,314	1,275	1,250	1,244

*Adjusted to reflect two-for-one stock split on April 10, 1968, April 14, 1970, and April 11, 1972.
1971 and prior restated for poolings of interests (note 2).

Statement of Consolidated Earnings

Years ended December 31, 1972 and 1971	1972	1971 (Restated—Note 2)
Net sales	**$631,917,797**	$556,062,224
Cost of goods sold, buying and warehousing costs	**370,278,649**	322,761,452
	261,639,148	233,300,772
Store operating, selling, general and administrative expenses	**195,576,790**	175,369,427
Depreciation and amortization	**9,308,816**	7,769,221
Interest charges	**2,755,011**	2,477,662
	207,640,617	185,616,310
	53,998,531	47,684,462
Other income (expense)—net	**1,007,705**	(40,164)
Earnings before Federal income taxes and minority interests	**55,006,236**	47,644,298
Provision for Federal income taxes (note 4)	**23,510,000**	19,653,120
	31,496,236	27,991,178
Minority interests in net earnings	**2,452,514**	2,031,672
Net earnings	**$ 29,043,722**	$ 25,959,506
Net earnings per share—common stock (note 8)	**$ 1.18**	$ 1.05

See accompanying notes to consolidated financial statements.

Financial Review

Earnings

Consolidated net earnings increased for the ninth consecutive year to $29,043,722 for the year 1972, an increase of $3,084,216, or 11.9% over the $25,959,506 for 1971.

Earnings per common share increased to $1.18 for the year 1972 an increase of 12.4% as compared to $1.05 for 1971 adjusted for a 2-for-1 stock split on April 11, 1972.

Sales

Consolidated net sales reached a new high for 1972 amounting to $631,917,797 an increase of 13.6% as compared to $556,062,224 a year ago.

Dividends

During the year 1972, the Company paid a dividend of $.416 per share. The quarterly dividend on common stock was increased to $.10816 per share in January 1973 from $.104 paid in 1972. The dividend on an annual rate amounts to $.43264 per share, the maximum permitted under Federal guidelines, compared to $.416 per share paid in 1972.

Property, Plant and Equipment

Capital additions for the year 1972 amounted to $17,785,127 as compared to $22,383,252 for 1971 a decrease of $4,598,125.

Depreciation charged for the year 1972 was $9,308,816 and $7,769,221 for the year 1971.

Capital Stock

The shareholders approved on April 11, 1972 a 2-for-1 split of the common stock and an increase in the authorized common shares from 15,000,000 to 30,000,000 shares.

Acquisitions

In December 1972, the Company completed the acquisitions of Metro Pants/Spotwood Apparel companies and Clinton Merchandising Inc., on a pooling-of-interest basis and has restated prior years financial statements.

Balance Sheets

as of December 31, 1972 and 1971	1972	1971 (Restated—Note 2)
Assets		
Current assets:		
Cash	**$ 31,141,250**	$ 34,085,005
Accounts receivable, less allowance for doubtful accounts	**19,951,692**	13,552,076
Inventories (note 1)	**130,748,421**	115,407,120
Prepaid expenses	**3,166,607**	2,128,433
Total current assets	**185,007,970**	165,172,634
Property, plant, equipment and leasehold improvements, at cost (notes 1 & 3):		
Land	**2,466,757**	2,424,128
Buildings	**7,911,978**	7,505,800
Machinery and equipment	**9,089,301**	8,146,869
Store and office fixtures, improvements to leased properties and miscellaneous equipment	**98,427,291**	87,739,309
	117,895,327	105,816,106
Less accumulated depreciation and amortization	**53,074,297**	47,471,828
Net property, plant, equipment and leasehold improvements	**64,821,030**	58,344,278
Deferred charges and other assets (note 3)	**3,548,845**	2,100,395
	$253,377,845	$225,617,307

See accompanying notes to consolidated financial statements.

	1972	1971 (Restated—Note 2)
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	**$ 52,724,871**	$ 50,922,158
Federal income taxes	**7,904,420**	8,463,903
Current installments on long-term debt	**571,557**	444,520
Total current liabilities	**61,200,848**	59,830,581
Long-term debt (note 5)	**34,841,732**	36,068,448
Deferred credit (note 1)	**440,450**	570,450
Deferred credit on condemnation of property (note 3)	**6,620,000**	—
Deferred Federal income taxes (note 4)	**1,188,194**	2,253,951
Lease obligations for closed stores	**914,530**	1,123,629
Minority interests in subsidiaries	**7,683,935**	5,945,969
Shareholders' Equity (notes 1, 5, 6 & 7):		
Preferred stock, Series B, $4.00 dividend, par value $100.	**8,889,400**	9,204,400
Common stock, par value $1.00, authorized 30,000,000 shares; issued and outstanding 24,442,311 in 1972 and 24,330,223 in 1971	**24,442,311**	12,640,247
Capital surplus	**4,119,288**	13,934,038
	37,450,999	35,778,685
Retained earnings	**103,315,517**	84,246,359
	140,766,516	120,025,044
Less cost of preferred shares in treasury	**278,360**	200,765
	140,488,156	119,824,279
	$253,377,845	$225,617,307

Commitments and contingencies (notes 4, 5 and 9)

Consolidated Statements of Shareholders' Equity

Years ended December 31, 1972 and 1971

	Series B Cumulative Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock
Balance at December 31, 1970					
As previously reported	$9,706,600	$21,995,785	$ —	$ 63,756,815	$(496,995)
Pooled companies	—	950,271	1,958,124	4,422,118	—
As restated	9,706,600	22,946,056	1,958,124	68,178,933	(496,995)
Net Earnings				25,959,506	
Purchases of Series B preferred shares for treasury					(267,121)
Cancellation of Series B preferred shares in treasury	(502,200)	171,276			330,924
Dividends					
Series B preferred				(359,724)	
Common				(9,329,932)	
Exercise of stock options		1,498,829			232,427
Transactions of pooled companies prior to acquisition				(202,424)	
Transfer to capital surplus that amount which exceeded the aggregate par value of common stock outstanding at December 31, 1971		(11,975,914)	11,975,914		
Balance at December 31, 1971, as restated	$9,204,400	$12,640,247	$13,934,038	$ 84,246,359	$(200,765)
Net Earnings				29,043,722	
Purchase of Series B preferred shares for treasury					(280,243)
Cancellation of Series B preferred shares in treasury	(315,000)		112,352		202,648
Dividends					
Series B preferred				(348,388)	
Common				(9,756,756)	
Exercise of stock options		112,088	1,489,444		
Transactions of pooled companies prior to acquisition			273,430	130,580	
Two-for-one common stock split		11,689,976	(11,689,976)		
Balance at December 31, 1972	$8,889,400	$24,442,311	$ 4,119,288	$103,315,517	$(278,360)

See accompanying notes to consolidated financial statements.

Statement of Changes in Consolidated Financial Position

Years ended December 31, 1972 and 1971	1972	1971 (Restated—Note 2)
Source of Funds:		
Net earnings	**$29,043,722**	$25,959,506
Expenses not requiring outlay of working capital:		
Depreciation and amortization	**9,308,816**	7,769,221
Minority interests in net earnings	**2,452,514**	2,031,672
Increase (decrease) in deferred Federal income taxes	**(1,065,757)**	906,798
	10,695,573	10,707,691
Working capital provided from operations	**39,739,295**	36,667,197
Increase in long-term debt	**—**	26,936,282
Proceeds from sale of common stock under stock option plans	**1,601,532**	1,731,256
Dispositions of property, plant and equipment	**1,999,559**	2,261,931
Proceeds from sale of subsidiaries' capital stock to minority interests, net of dividends	**(714,548)**	88,200
Transactions of pooled companies prior to acquisition	**404,010**	(202,424)
Payments received on condemnation	**6,620,000**	—
Other, net	**(130,000)**	71,215
	49,519,848	67,553,657
Application of Funds:		
Additions to property, plant and equipment	**17,785,127**	22,383,252
Reduction in long-term debt	**1,226,716**	773,080
Increase in deferred charges and other assets	**1,448,450**	2,050,584
Reduction (net) in lease obligations on closed stores	**209,099**	74,937
Cash dividends paid	**10,105,144**	9,689,656
Purchase of treasury stock—preferred	**280,243**	267,121
	31,054,779	35,238,630
Net increase in working capital	**$18,465,069**	$32,315,027
Net increases in working capital is comprised of:		
Increase (decrease) in current assets:		
Cash	**(2,943,755)**	22,244,784
Accounts receivable	**6,399,616**	(717,478)
Inventories	**15,341,301**	17,546,997
Prepaid expenses	**1,038,174**	(1,575,939)
	19,835,336	37,498,364
Increase (decrease) in current liabilities:		
Notes payable to banks	**—**	(1,350,000)
Accounts payable and accrued expenses	**1,802,713**	5,936,724
Federal income taxes	**(559,483)**	372,723
Current installments on long-term debt	**127,037**	223,890
	1,370,267	5,183,337
	$18,465,069	$32,315,027

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(1) SUMMARY OF ACCOUNTING POLICIES

Principles of Consolidation: The consolidated financial statements include the accounts of Melville Shoe Corporation and its subsidiary companies, which are wholly-owned except for an 80% owned foreign manufacturing subsidiary, certain 75% owned retail subsidiaries, and a 55% owned foreign purchasing subsidiary. All intercompany items and transactions have been eliminated.

Inventories: Approximately 95% of the consolidated inventories are valued at the lower of cost or market, based mainly on the retail inventory method. The remaining portion of inventories are valued at last-in, first-out (LIFO) cost, which is substantially below market. For the inventories valued at LIFO cost, replacement cost exceeded such LIFO cost at December 31, 1972 by $8,267,563 and at December 31, 1971 by $7,084,783.

Depreciation and Amortization: Depreciation and amortization of plant and equipment are provided for accounting purposes on the straight-line method over the estimated useful lives of the assets.

Maintenance and Repairs: Maintenance expense and repairs are charged directly to the appropriate operating account at the time the expense is incurred. Major renewals or replacements are capitalized after making necessary adjustments in the asset and accumulated depreciation accounts for the items renewed or replaced.

Pension Plans: The Company and its subsidiaries have several pension plans which cover substantially all of its employees. The provision for pension costs includes amortization of past service costs, less amortization in annual installments to 1978 of a deferred credit representing the amount provided for pensions prior to adoption of funding for all plans. Past service costs are being amortized over a period of 24 years commencing January 1, 1973.

The total of pension funds and amounts accrued for pensions was in excess of the actuarially computed value of vested benefits as of December 31, 1972. Unfunded past service costs at December 31, 1972 aggregated approximately $5,402,193. The Company's provisions under pension plans aggregated $1,550,795 in 1972 and $1,358,344 in 1971.

(2) ACQUISITIONS

In December, 1972, the Company acquired Metro Pants Company, Inc. and its affiliated companies, a manufacturer and wholesaler of boys' and young men's pants, and Clinton Merchandising Inc., a chain of retail drug and health and beauty aid stores, for 284,000 and 666,271 shares of common stock, respectively. Each transaction has been accounted for as a pooling of interest and the consolidated financial statements for 1971 have been restated to reflect such acquisitions.

Net sales and net earnings before and after the poolings of interests are summarized as follows:

	1972	1971
Net Sales:		
Before 1972 poolings	$582,938,545	$512,709,692
Sales of pooled companies	48,979,252	43,352,532
Net sales as reported herein	$631,917,797	$556,062,224
Net Earnings:		
Before 1972 poolings	$ 27,298,486	$ 24,535,416
Earnings of pooled companies	1,745,236	1,424,090
Net earnings as reported herein	$ 29,043,722	$ 25,959,506

In restating the statement of consolidated earnings for 1971, results of operations of the acquired companies are included on the basis of their respective fiscal year-ends. In conforming the various fiscal year-ends to that of the Company, the results of operations of the acquired companies for the intervening periods have been credited to retained earnings in 1972. Net sales and net income for such periods were $22,147,636 and $309,581, respectively.

(3) PROPERTY, PLANT AND EQUIPMENT

Pursuant to an order of condemnation, a subsidiary of the Company was compelled to surrender possession of certain land and building on April 20, 1971. The subsidiary has recorded as a deferred credit, $6,620,000 in payments it received in 1972 toward the final award. Relocation and related expenses incurred by the Company have been deferred and will be applied to the proceeds of the final award when received. In the opinion of management, the Company will not sustain any loss on the disposition of these assets.

(4) FEDERAL INCOME TAXES

(a) The Company accounts for the investment tax credit under the flow-thru method for both financial and income tax purposes. The provision for Federal income taxes has been reduced by investment tax credits of $526,000 in 1972 and $212,000 in 1971.

(b) Deferred Federal income taxes have been provided to reflect the difference in timing of certain transactions for accounting and tax purposes. Such differences arise from depreciation, lease obligations and expenses relative to closed stores, and proceeds and costs relative to the condemnation proceeding.

The provision for Federal income taxes includes deferred taxes of ($1,308,000) in 1972 and $992,000 in 1971.

(c) In connection with an examination of tax returns of the Company and its subsidiaries, the Internal Revenue Service in 1969 questioned the claiming of separate surtax exemptions for the subsidiary companies. Separate surtax exemptions have been accepted by the Service for all years prior to 1964 and, in the opinion of the Company, they were allowable under the then existing legislation. Pursuant to the Tax Reform Act of 1969, multiple surtax exemptions for controlled groups are being phased out over a six-year transitional period which commenced in 1970.

The Company is presently discussing the possible settlement of this matter with the Service for the years 1964 through 1971. Any additional taxes resulting from the final disposition of this matter would be accounted for as a prior period adjustment and charged to the year to which the taxes apply. If consolidated returns had been filed for 1972 and 1971, the approximate reduction in earnings per share would have been $.02 and $.05, respectively.

(5) LONG-TERM DEBT

Long-term debt at December 31, 1972 and 1971 consisted of the following:

	1972	1971
4⅞% Convertible Subordinated Debentures, due June 1, 1996	$25,000,000	$25,000,000
4⅞% Debentures, due 1980	5,400,000	6,000,000
3½% Promissory Note, payable in quarterly installments through 1984	1,561,000	1,669,000
6¼% Mortgage Notes, payable in monthly installments through 1989	1,435,911	1,488,556
7½% Mortgage Notes, payable in monthly installments through 1999	524,366	547,002
7¼% Note, payable in quarterly installments through 1977	827,619	1,127,619
Other mortgages and notes payable	664,393	680,791
Less current installments	(571,557)	(444,520)
Total long-term debt	$34,841,732	$36,068,448

The 4⅞% Convertible Subordinated Debentures are convertible into common stock at the option of the holder up to June 1, 1996 at a price of $32 per share, subject to adjustment in certain events. The Debentures are redeemable at the option of the Company at 104.631% of the principal amount on or before May 31, 1973, and thereafter at declining amounts to par. The Indenture provides for the establishment of a sinking fund commencing in 1982.

The Indentures relating to the 4⅞% Convertible Subordinated Debentures due 1996 and the 4⅞% Debentures due 1980 contain provisions for certain restrictions as to payment of cash dividends and retirement of the Company's capital stock. At December 31, 1972, $35,502,278 of the consolidated retained earnings was so restricted.

(6) CAPITAL STOCK

On April 11, 1972, the shareholders approved a two-for-one common stock split and an increase in the authorized shares of $1 par value common stock from 15,000,000 to 30,000,000 shares.

(7) STOCK OPTION AND STOCK PURCHASE PLANS

Stock Option Plan: Under a stock option plan adopted in 1964, options have been granted to key managerial employees, at fair market value on date of grant. The right to exercise such options commences one year from the date of the grant and expires five years after such date. At December 31, 1972, 577,490 shares of common stock were reserved under the plan, options for 507,330 shares were exercisable, and 14,660 shares were available for grant under the plan.

Information with respect to options granted under the plan is as follows:

	Number of Shares	Price Range Per Share
Shares under option at December 31		
1971	623,418	$ 8.55-$28.69
1972	562,830	$13.94-$37.13
Shares which became exercisable during:		
1971	33,000	$15.38-$15.63
1972	271,000	$28.69
Options exercised during:		
1971	155,132	$ 3.81-$17.94
1972	112,088	$ 8.55-$28.69

Stock Purchase Plan: Under an incentive stock purchase plan covering a maximum of 800,000 shares of common stock, key managerial employees may purchase shares of common stock within two years from the date such stock is offered to them. The minimum purchase price is the higher of (1) book value per share as of the fiscal year-end preceding the date of offer, or (2) 50% of the fair market value at the date of offer. No shares were offered for purchase during 1970, 1971 and 1972. During 1971, 2,140 shares offered during 1969 were purchased under the plan.

(8) EARNINGS PER SHARE

Earnings per share have been computed based on the average number of common shares outstanding during each year as adjusted for a stock split and shares issued in poolings of interests transactions. The conversion of the Convertible Subordinated Debentures and exercise of the outstanding stock options would not result in any dilution of earnings per share.

(9) COMMITMENTS

Total minimum annual rentals (exclusive of amounts based on sales) payable under leases amounted to approximately $26,300,000 at December 31, 1972. Such leases will expire on various dates to the year 2000, however, it is anticipated that as leases expire they will be renewed or new leases will be executed. Total rent expense amounted to approximately $53,100,000 in 1972 and $44,520,000 in 1971.

Accountants' Report

PEAT, MARWICK, MITCHELL & CO.
Certified Public Accountants
345 Park Avenue
New York, New York 10022

To the Board of Directors
and Shareholders
Melville Shoe Corporation:

We have examined the consolidated balance sheets of Melville Shoe Corporation and subsidiary companies at December 31, 1972 and at December 31, 1971, and the related statements of earnings, shareholders' equity, and changes in financial position for each year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, subject to final determination of Federal income tax liability as described in note 4c of notes to consolidated financial statements, the accompanying consolidated financial statements present fairly the financial position of Melville Shoe Corporation and subsidiary companies at December 31, 1972 and at December 31, 1971, and the results of their operations and changes in financial position for each year then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Peat, Marwick, Mitchell & Co.

February 26, 1973

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MELVILLE SHOE CORPORATION, 3000 WESTCHESTER AVENUE, HARRISON, NEW YORK 10528

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FRANCIS H. GLEASON
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Annual Meeting of Stockholders will be held at Melville Corporate Headquarters
3000 Westchester Avenue, Harrison, New York • at 10 a.m., April 10, 1973

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67 Millbrook Street
Worcester, Mass. 01606

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Registrar:
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